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Is corporate income tax a withholding tax? Some comments on the *Athinaïki Zythopoiia* case

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1. Introduction

The preliminary ruling given on 4 October 2001 in the *Athinaïki Zythopoiia* case (C-294/99), is the third one (after the *Denkavit* and the *Epson Europe* decisions[1]) related to the implementation, within Member States, of Directive 23 July 1990, no. 435 (Parent-Subsidiary Directive).

The above-mentioned ruling, as the previous one, dated 8 June 2000, in the *Epson Europe* case, fills a gap of the Directive, i.e. the lack of a definition of the concept of 'withholding tax'. Both decisions have entailed a material broadening of the mentioned concept, which now goes beyond the one generally adopted in the Member States' law.

2. The provisions of the Directive with respect to withholding taxes

The Directive provides (Art. 5, para. 1) that dividends distributed by a subsidiary company to the parent company are exempt from withholding tax, but the term is not expressly defined (neither in general nor with respect to Member States).[2] Article 7, para. 1 specifies, however, that 'the term «withholding tax as used in this Directive shall not cover an advance payment or prepayment (précompte) of corporation tax to the Member State of the subsidiary which is made in connection with a distribution of profits to its parent company'. The exclusion, as authoritatively pointed out, concerns only those cases where the distribution of dividend implies the obligation of advance payments (related to the corporate income tax of the distributing company), reference being made to the advance corporation tax, at that time collected in Ireland and in the United Kingdom.[3]

Furthermore, the prohibition of retention at source

[1] Judgments 17 October 1996, *Denkavit Internationaal e a. v Bundesamt für Finanzen*, joint cases 283/94, 291/94 and 292/94, 1996, ECR, I, 5063; 8 June 2000, *Epson Europe*, case 375/98, 2000, ECR, I, 4243.

[2] Conversely, the initial Proposal of 16 January 1969 (COM (69)6*fin.*, in OJ, C 39 of 22 March 1969, p. 7) contained, at Art. 5, an expressed list, including: the *précomte mobilier* in Belgium, the *Kapitalertragsteuer* in the German Federal Republic, the *retenue à la source* in France, the *ritenuta alla fonte* in Italy, the *retenue d'impôt* in Luxembourg and the *dividendbelasting* in the Netherlands.

[3] G. Maisto, *Il regime tributario dei dividendi nei rapporti fra 'società madri' e 'società figlie'* (Milano, 1996), p. 86. It is worth remarking that the Advance Corporation Tax, notwithstanding the exclusion from the scope of application of the Directive was nonetheless afterwards repealed in consideration of its conflict with the general principles of community law, stated in judgment 8 March 2001, *Metalgesellshaft e a.* (joint cases 397/98 e 410/98, 2001, ECR, I, 1727). The Court has recognized, in the ACT legislation a financial discrimination towards non-residents (incompatible with the freedom of establishment). The Advance Corporation Tax was repealed the UK Finance Act 1998, with effect on 6 April 1999. See, on the relationship between ACT and the Directive, M. Gammie, 'Imputation system and foreign income: the UK Surplus ACT problem and its relationship to European Corporate Tax harmonization', in *Intertax* 1991, p. 54. On the repeal of ACT and the *Metalgesellshaft* case, R. Newey, 'Hoechst Decision: Interest as Compensation for Discriminatory Tax Charge', in *European Taxation* 2001, p. 287; M. Richardson, 'Practical Justice Instead of Academic Controversy – the Hoechst Decision', *British Tax Review* 2001, no. 4, p. 273: A. Craig, 'Show Me the Money: What the ECJ's Decision in Hoechst Could Mean for the United Kingdom's Tax Haven Legislation', *Bulletin* 2002, p. 19.

has been mitigated by a series of exceptions (peremptorily) provided for in paras. 2, 3 and 4 of Art. 5 of the Directive with reference, respectively, to Germany, Portugal and Greece. In particular, Art. 5, para. 2 considers that 'the Hellenic Republic may, for so long as it does not charge corporation tax on distributed profits, levy a withholding tax on profit distributed to parent companies of other Member States. However, the rate of that withholding tax must not exceed the rate provided for in bilateral double-taxation agreements'. The exception granted to Greece does not, however, come into play within the sphere of the dispute under discussion since it has become ineffective after a reform of the Greek system implemented in 1992.[4]

The described approach adopted by the Community legislator (who has not been involved with respect to the definition of withholding at source, except for the mentioned exclusions) has therefore left a certain degree of uncertainty, opening the door to Court interpretation.

3. The facts and the Hellenic legislation

The case in question can be summarized as follows. *Athinaïki Zythopoiia AE* had distributed, in 1996, to its Dutch corporate shareholder, dividends (qualifying for the Directive exemption at source) made up, among else, by previous year profits which had been either exempted from corporate income or subject to a reduced tax regime.[5]

According to the Greek legislation, the exemption (or the reduced taxation) is acknowledged only if income is allocated to a 'deferred tax' reserve (i.e. a reserve subject to income tax in the event of a distribution, regardless of current or carry-forward losses in the year of distribution).[6] In balance, dividend is not subject to any declared withholding, nor to any further income taxation on the head of the shareholder: the Greek state adopts, in principle, the exemption method.

The company had claimed that the described taxation upon distribution (ruled by Art. 106, nos. 2 and 3 of the Greek Income Tax Code) was a breach of the mentioned prohibition of withholding tax provided by Art. 5, para. 1 of the Directive.

4. The Court methodology

The Court has expressly adopted an autonomous interpretation of Art. 5, para. 1 of the Directive, based on the remark that 'it is settled case-law that the nature of a tax, duty or charge must be determined by the Court, under Community law, according to the objective characteristics by which it is levied, irrespective of its classification under national law'.[7] Such approach is linked with the principle of autonomy of Community law[8] and arises from the necessity of ensuring its uniform application within the Community, rejecting, where necessary, interpretations based on the meaning which the controversial expression assumes within the sphere of individual national systems.[9] After having been adopted in relation to equal treatment of workers,[10] to immunity of European Parliament members[11] and to sector policies,[12] the principle of autonomous interpretation has for some time now found an application in the area of

4 The circumstance is mentioned at para. 22 of the Opinion of Advocate-General Alber, filed on 10 May 2001. One the derogation and the Greek 1992 reform, see N. Nikolopulos, 'The implementation of the Parent-Subsidiary Directive in Greece', in *EC Tax Review*, April 2002, p. 13.

5 More precisely, as pointed out in the Opinion of the Advocate-General, exempt income mainly consisted of surplus from the trading of shares in mutual funds (Art. 48, para. 3 of Law 1969/91) while income subject to special tax was made up of interest on bank deposits (Art. 12, paras. 1 and 2 of Law 2238/1994).

6 The regulation, contained in Art. 106, paras. 2 and 3 of Law 2238/94, as quoted in the text of the judgment, provides, with reference to exempt income, that '2. If the net profits arising from the balance sheet of cooperatives, limited liability companies or Greek public limited companies, with the exception of banking and insurance concerns, also include non-taxable income, in order to determine the taxable profits of the legal person there shall be added thereto the fraction of non-taxable income corresponding to distributed profits in any form, after transformation of that amount into a gross amount by the addition of the corresponding tax . . .'. The same regime is extended, by Par. 3, to income subject to reduced taxation: '3. The provisions of the previous paragraph shall also apply by analogy to the distribution of profits by limited liability companies, Greek public limited companies, with the exception of banking and insurance concerns, and by cooperatives whose profits also include profits subject to special determination or taxation in their own name'.

7 Cf. para. 27 of the judgment.

8 As pointed out by J. M. de Wilmaars, 'Réflexions sur les méthodes d'interprétation de la Cour de justice des Communautés européennes', in *Cahiers de Droit Européen* 1986, p. 8, '*Le point de départ du raisonnement interprétatif auquel elle a recours est basé sur la constatation que, si le Communautés trouvent leur origine dans des traités, elles constituent cependant un ordre juridique spécifique et autonome*'. Likewise, more recently, K. Lenaerts, 'Le droit comparé dans les travail du juge communautaire', *Cahiers de Droit Européen* 2001, p. 491.

9 However, as J.M. de Wilmaars, see n. 8 above at p. 17 remarks, also in the light of judgment of 17 December 1970, *Internationale Handelsgesellschaft* (case 11/70, 1970, ECR, 1970, 1125) the mentioned approach does not prevent, in general, from the recourse to *common* general principles of the Member States (following the 'comparative' method).

10 The guidance dates back to the preliminary ruling in *Unger*, 19 March 1964, C-75/63, 1964, ECR, 351and has been reaffirmed more recently, always with reference to the equality of treatment of workers in judgments 4 June 1992, *Boetel*, C 360/90, 1992, ECR, 1992, 3613; 6 February 1996, *Lewark*, 475/93, 1996, ECR, 266; 7 March 1996, *Freers*, 278/93, 1996, ECR, 1165. As it can be read in the most recent judgment 'it must be observed first of all that legal concepts and definitions established or laid down by national law cannot affect the interpretation or binding force of Community law'.

11 Judgment 10 July 1986, *Wybot/Faure*, C-149/85, 1986, ECR, I, 2391.

12 According to the ruling on 14 January 1992, *Corman*, 64/81, 1982, ECR, 13, 'the community legal order does not in fact aim in principle to define its concepts on the basis of one or more national legal systems without express provision to that effect'. Likewise, on 16 January 1997, *Buratti/Tabacchicoltori Associati Veneti*, C-273/95, 1997, ECR, 223, the Court stated that 'the concept of "delivery" cannot depend on national classification under civil, commercial or revenue law. If that were the case, the common organization of the market would be applied differently in the Member States in areas of particular importance to its proper working, namely the time-limit for payment of premiums, determination of the conversion rate and carrying out checks'.

excise duties,[13] of indirect taxes[14] and, lastly – starting with the case mentioned of *Epson Europe* – to the subject of income tax.

In other words, the procedure followed in the case of *Epson Europe* and *Zythopoiia* is similar to that traditionally adopted by the Court on the subject of harmonization of value added tax, in particular, in order to establish when, in accordance with Art. 33 of Directive 77/388/CEE, a determined national tax has 'the nature of a tax on turnover'.[15] A similar question also arises in numerous decisions affecting the harmonization of capital duties and the prohibition (ruled by Art. 10 of Directive 69/335/CEE) of any similar taxes on transactions, which fall within the scope of application of the provision.[16]

5. The '*economic translation*' and the corporate income tax as a (possible) withholding tax

Following the methodological approach described, the Court has attempted (since *Epson Europe*) to highlight a concept of 'withholding tax' based on Community law and leaving apart within the consolidated national qualifications. The task is made all the more difficult by the fact that the Directive introduces such concept by means of a metonymy, i.e. identifying the national taxes with respect to which the prohibition of Art. 5, para. 1 operates, not by means of a general definition or by means of a complete enumeration (as happened in the 1969 Proposal), but on the basis of the *method* of application.

Accordingly, in the *Epson Europe* judgment, it was observed that the term 'withholding tax' as used in the Directive 'is not limited to certain specific types of national taxation'. The same point was made within the 1995 IBFD survey, in which it was considered that the same term made reference to 'any additional tax, over and above corporation tax, on the profits distributed by the subsidiary'.[17]

It may be worth remarking that the solution adopted in 1990 by the EEC legislator is significantly different from the one generally traceable in international (treaty) law. In the field of dividend taxation, the difference may arise from the comparison with the provisions of Art. 10 of the OECD Model Tax Convention, which limits (para. 2) the taxation of dividends in the source state (the contracting state of which the company paying the dividends is a resident) but leaves apart the method of application of said taxes. As clarified in the Commentary, 'Para. 2 lays down nothing about the mode of taxation in the State of source. It therefore leaves that State free to apply its own laws and, in particular, to levy the tax either by deduction at source or by individual assessment'.

As far as the Directive is concerned, the ECJ gives its Opinion by developing a definition based on three criteria: a 'withholding tax' is; paid by the distributing company; due upon a distribution of dividends; and in direct relationship with the amount of said distribution. In more detail:

- as Advocate-General Alber observes in his Conclusions, the fundamental requirement ('*le principe même*') of a withholding tax is its method of application; i.e. the fact the tax 'is retained, and paid directly to the tax authorities, by the company making the distribution';[18]
- a further qualifying element occurs whenever (point 28 of the judgment), 'the chargeable event for the taxation … is the payment of dividends';
- finally, a third requirement concerns the extent of the levy, which must be 'directly related to the size of the distribution'.

Those are, indeed, the same criteria already developed in the *Epson Europe* case and which had led to qualifying the substitute estate tax, provided for by the Portuguese system, in contrast to Art. 5, para.1 of the Directive.[19] The fundamental difference between the

13 In such sense, see, for all, the ruling of 2 April 1998, *The Queen v Commissioners of Customs and Excise, ex parte EMU Tabac e.a.*, 296/95, 1998, ECR, 1605.

14 Judgment 13 February 1996, *Bautiaa e Société française maritime*, joint cases C-197/94 and C-252/94, 1996, ECR, I, 505, para. 39.

15 Reading the many decisions on the topic, a standard definition can be traced, according to which a turnover tax is a 'general tax on consumption which is exactly proportional to the price of the goods and services, irrespective of the number of transactions which take place in the production and distribution process before the stage at which the tax is charged … is chargeable on each transaction only after deduction of the amount of VAT borne directly by the costs of the various price components'. Cf. at the latest, the judgment of 19 February 1998, *SPAR Österreichische Warenhandels AG*, 318/96, 1998, ECR, I 785.

16 Art. 10 of Directive 69/335/CEE contains, in comparison with Art. 33 of Directive 77/388/CEE, a more detailed description of prohibited similar taxes. Such circumstance has not avoided, along the years, the onset of qualification issues. See, for instance, judgment 26 September 2000, *IGI – Investimentos Imobiliários SA*, 134/99, 2000, ECR, I, 7717, which is based on a general definition according to which 'registration charges levied by the State for a transaction covered by the Directive and paid to it in order to subsidize public expenditure must be regarded as a tax for the purposes of the Directive'.

17 See IBFD, *Survey of the Implementation of the EC Corporate Tax Directives* (Amsterdam, 1995), p. 377, where it is also remarked that 'these taxes are usually, but not necessarily withheld at source'. According to a different interpretation, Art. 5, Para. 1 of the Directive could, on the contrary, only have been applied with reference to income taxes. Cf. G. Maisto, 'La direttiva Cee relativa al regime tributario dei dividendi nei rapporti tra "società-figlie" e "società-madri"', in *Rivista di diritto tributario* 1992, I, p. 574 and Maisto, n. 3 above, p. 81.

18 See the Opinion of the Advocate-General, point 32. The illustrated position is based on the consideration (at point 25) that 'the concept of withholding tax becomes even clearer when regard is had to the fact that, in the field of conflict of laws in taxation matters, it typically forms the counterpart to the principle of worldwide taxation. There it designates the imposition of local taxes on the local income of non-residents. When an undertaking's profits are distributed to non-residents (but also to residents), there is a withholding tax in that the undertaking making the distribution deducts the tax from the distribution and pays it directly to the tax authorities'.

19 The issue of the possible conflict between Art. 5, para. 1 of the Directive and the '*imposto sobre as sucessões e doações*' (levied upon any dividend distribution, as provided by Art. 182 e 184 of the *Código do Imposto Municipal da Sisa e do Imposto sobre as Sucessões e Doações*) had already been raised before the Court case. According to the IBFD's *Survey, see n. 17 above, p.* 377, 'the imposition of such tax is clearly in breach of the Directive'. For a recent comment on the Court judgment, see F. de Sousa da Camara, 'Parent-Subsidiary Directive: the Epson Case', *European Taxation*, September 2001, p. 307.

two cases (and, therefore, the most significant development of the judgment commented upon) is that the Court has come to the conclusion that even a tax borne by the distributing company can, under certain conditions, be qualified as a withholding tax, consequently not permitted under the mentioned Art. 5, para. 1, of the Directive.

As affirmed by the Advocate-General, in his Conclusions (implicitly endorsed on the point, but not reproduced, in the judgment) an economic transfer[20] of the tax to the shareholder was realized ('the economic effect of taxation of the subsidiary is tantamount to taxation of the parent company'), which leads to qualify the Greek tax levied on the company as a withholding tax.

Indeed, the conception of corporate taxation as an 'economic' withholding on the shareholders' income is not devoid of supporting arguments, at least from an economic and policy perspective. The idea was, among else, briefly developed in the Ruding Report, in the context of a discussion on the role (and the need) of corporate income taxes in Europe, also in the light of a position taken in 1964 by the Canadian Royal Commission on Taxation.[21] Conversely, such an approach would hardly be consistent with the framework of national jurisdictions (at least, from an Italian perspective[22]) and seems to be also in conflict with international tax treaty law. The already mentioned Art. 10, para. 2 of the OECD Model Convention (identical, on the point, to both the UN and the US Models) in dealing with the (limited) taxation of dividend at source, clarifies that 'this paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid'.

The position of the Court does not fall within those schemes. The judgment, indeed, attributes crucial importance to the fact that, contrary to the general principle laid down in Greek law, enabling losses to be carried forward, 'the increase in the basic taxable amount generated … by the distribution of profits cannot be offset by the subsidiary using negative income from previous tax years'. The impossibility of compensating for (any) carry forward losses with the positive component resulting from the distribution of the deferred tax reserve, would configure the corresponding tax as an independent and distinct levy with respect to corporate income tax and, for this reason, ascribable within the sphere of the concept of 'withholding tax'.

In other words, corporate income tax remains external to the scope of application of Art. 5, para. 1, even should the obligation arise at the time of distribution of dividends. Rather, to follow the guidance of the Court, it is necessary to evaluate, on a case by case basis, whether a levy applied to the company, at the time of distribution of dividends, can be ascribable to corporate tax or whether it constitutes a distinct tax.

6. Possible arguments against the above qualification

The outlined decision should be considered in the light of two possible critical arguments.

First, it can be questioned whether the Directive does not contain a (at least, '*a contrariis*') definition of 'withholding tax'. In fact, it can be argued that the application, by a Member State, of a corporate tax included among those listed at Art. 2, para. 1(c) of the Directive:[23]

- concerns the 'economic' double taxation of the dividend, and is governed by Art. 4, which places the burden of the remedy on the residence state: essentially, the exemption of said dividends or, as an alternative, the acknowledgment of an '*indirect*' tax credit against the taxes paid by the subsidiary company;[24]
- it should not, then, concern the prohibition of source state taxation provided by Art. 5, para.1, which is aimed at avoiding the 'legal' double taxation of dividends.

In other words, the taxes in Art. 2, para. 1(c) would remain excluded from the scope of application of the prohibition of Art. 5, para. 1, as they already constitute the object of the obligations of Art. 4.[25] If this approach is followed, for the purposes of qualification of a tax such as 'withholding at source' it would therefore

[20] The economic effects of a given tax and, in particular of the economic (*de facto*) passing-over of the related burden have already been taken into consideration in the field of turnover taxes (see 26 June 1997, *Careda S. A.*, joint cases 370/95, 371/95 and 372/95, 1997, ECR, I, 3721). While discussing whether the Spanish tax on gambling and betting was a forbidden 'turnover tax' for the purposes of Art. 33 of the Directive 77/388/CEE, the Court has held that 'in order for a tax to be characterized as a turnover tax, it is not necessary for the relevant national legislation expressly to provide that it may be passed on to the consumer'.

[21] European Commission, Report of the Committee of Independent Experts on Company Taxation (Ruding Report), Brussels, 1992.

[22] From an Italian standpoint, for example, the legal obligation to withhold the tax is generally considered an essential element of the notion of withholding tax. Otherwise, the beneficiary of the income could not be qualified as a taxpayer. See, on the issue, G. Falsitta, *Manuale di diritto tributario. Parte Generale*, 2nd ed. (Padova, 1997); R. Lupi, *Diritto tributario. Parte Generale*, 7th ed. (Milano, 2000), p. 311; E. de Mita, *Principi di diritto tributario*, 2nd ed. (Milano, 2000), pp. 23 and 279; P. Russo, *Manuale di diritto tributario*, 3rd ed. (Milano, 1999), p. 163.

[23] It can be assumed that listing of the national taxes in Art. 2, para. 1, letter (c) of the Directive is valid not only for specifying the (subjective) requirement of the subjugation to tax, but also to define the scope of (objective) application of Art. 4 of the Directive, that is, identifying the taxes with respect to which the parent company state is required, depending on the cases, to grant exemption or credit. See G. Maisto, n. 3 above, p. 25, who remarks that economic double taxation is connected with the similarity of taxes and, furthermore, Art. 4 makes constant and reiterated reference to one tax, which cannot be other than one of those listed in Art. 2.

[24] In such perspective, the point made by the Advocate-General (according to whom 'the economic effect of taxation of the subsidiary is tantamount to taxation of the parent compan') may be reconsidered: the described effect is, indeed, at the basis of the economic double taxation of dividends, which already finds a remedy within Art. 4 of the Directive.

[25] The proposed argument does not seem to be in conflict with the position taken by Advocate-General G. Cosmas in the *Epson Europe BV* case. He affirmed, on that occasion, that 'withholding tax cannot be interpreted as being confined to the taxes listed by name in Article 2, since it applies to all taxes levied in the Member State of the subsidiary on distributed profits (dividends)'.

further be necessary to ascertain whether it falls within those detailed in Art. 2, para. 1(c) of the Directive or not. With this procedure, the reference to the national taxes referred to in detail therein ('or to any other tax which may be substituted for any of the above taxes') should involve – in the place of the recourse to an autonomous interpretation – the necessary return to the national law involved, [26] even within the limits represented by the obligation of cooperation.[27]

Secondly, it should be discussed whether the conclusion reached by the Court is consistent with the *purpose* of the Directive, expressed in the preamble ('whereas').[28] More precisely, the Directive is based on the idea that 'the grouping together of companies of different Member States … ought not to be hampered by restrictions, disadvantages or distortions arising in particular from the tax provisions of the Member States', while the cooperation among these companies would otherwise be hampered by tax provisions 'less advantageous than those applicable to parent companies and subsidiaries of the same Member State'. In the above framework, the withholding tax exemption has been provided 'in order to ensure tax neutrality'. In the *Zythopoiia* case, such a restriction (or distorsion) does not seem to exist, since the questioned Greek provision is applicable to both resident and non-resident shareholders. In fact, not only does the Greek system not distinguish on the basis of the residence of the shareholder but, from a wider perspective, neither is unequal (overall) treatment of the shareholder recognisable, taking into consideration that – in the case in question – both the Hellenic system and the Dutch system (subject to certain conditions) provide for the exemption of dividends, ensuring, in fact, a situation of perfect neutrality.[29] The effect of the judgment, therefore, is not the elimination of a (non-existent) distortion, but the creation of a preferential treatment.

From a more general perspective, the solution arising from the judgment may, on the contrary, generate a conflict with some of the principles laid down in the field of harmful tax competition and included in the Code of Conduct on Business Taxation[30] (adopted on 1 December 1997).

In fact, based on the Court decision, residents of other Member States (qualifying for the withholding exemption) would not be taxed on Greek sourced (temporary) exempt income, which is conversely taxed on the head of resident shareholders (even though only upon distribution). In other words, the Directive would transform the temporary domestic Greek exemption in a permanent exemption, to the exclusive benefit of non-residents.

The resulting regime seems to create, to follow the wording of the Code of Conduct, 'advantages accorded only to non residents …' which provide for 'a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the Member State in question'. The measure resulting from the interaction of the Greek domestic legislation and the Community Directive (as interpreted by the Court in *Zythopoiia*) may then be regarded as potentially harmful.

7. The scope of application of Article 7, paragraph 2 of the Directive

The objection raised by the Hellenic Government, about the applicability to the case in question of the double taxation convention between Greece and the Netherlands (under which the withholding tax on dividends may not exceed 35 per cent), also provided a chance to look into the merits of the relationship between Community law and bilateral agreements.

The issue is centered on Art. 7, para. 2 of the Directive, which 'shall not affect the application of domestic or agreement-based provisions designed to eliminate or lessen economic double taxation of dividends, in particular provisions relating to the payment of tax credits to the recipient of dividends'. On such matter the Court, after having examined the Treaty between Greece and the Netherlands, observes that such Treaty, since it permits the taxation of dividends in the source country, 'far from eliminating or lessening double taxation of dividends … provides

[26] Although the case law of the Court is inspired by the principle of autonomy of EU Law, national rules are nonetheless taken into consideration if national law is referred to in the EU legislation. See judgments 14 January 1992, *Corman*, (para. 8); 2 April 1998, *EMU Tabac*,. (para. 30); 14 March 1996, *Van der Linden*, case 275/94, 1996, ECR, 179. In the judgment 15 May 1990, *Hagen/Zeehaghe*, 365/88, 1990, ECR, 1845, related to the Brussels Convention of 27 September 1968, the Court has clarified that the national Court 'may apply the procedural rules of its national law in order to determine whether that action is admissible, provided that the effectiveness of the Convention in that regard is not impaired'.

[27] According to Art. 10 (ex-Art. 5) of the Treaty, 'Member States shall take all appropriate measures, whether general or particular, to ensure fulfillment of the obligations arising out of this Treaty or resulting from action taken by the institution of the Community'. The provision, which contributes to the balance of powers and duties between the Community and the Member States, implies that the latter should 'take all measures necessary to guarantee the application and effectiveness of Community law' (21 September 1989, *Commission v* Greece, case 68/88, 1989, ECR, 2965) and should abstain from any opposite measure. On the matter, see F. Tesauro, *Diritto comunitario* (Padua, 1995), p. 87; P. Craig, G. de Burca, *EU Law*, 2nd ed. (Oxford, 1998), p. 393.

[28] On the function of Preambles in the interpretation of a Community Act, see, in particular, the judgment of 26 March 1996, *Garcia e.a.*, 238/94, 1996, ECR, 1686. The Court held that the examination of Preambles is unnecessary only in view of 'clear and precise terms'.

[29] Since income earned by the Dutch shareholder has the same (overall) treatment as Greek (domestic) dividend income, this seems, indeed, a case of 'capital import neutrality', according to the definition developed by P. Musgrave, *United States Taxation of Foreign Investment Income. Issues and Arguments* (Cambridge, 1969). Said concepts are further developed in the tax law analysis of C. Garbarino, *La tassazione del reddito transnazionale* (Padua, 1990), p. 69.

[30] Resolution of the Council and the Representatives of the Governments of the Member States, meeting within the Council of 1 December 1997 on a code of conduct for business taxation, in OJ, C 2, of 6 January 1998. On the legal nature of the code of conduct and the relations with the state aid rules, C. Pinto, 'EU and OECD to Fight Harmful Tax Competition: Has the Right Path Been Undertaken?', *Intertax* 1998, p. 368; G. Rolle, 'Mercato interno e fiscalità diretta nel Trattato di Roma e nelle recenti iniziative della Commissione europea', Diritto e Pratira Tributaria, 1999, III, p. 57.

for such double taxation'.[31] The point may be of some interest with reference to those agreements (e.g. the one currently in force between Italy and France) which actually contain provisions aimed at counteracting economic double taxation of dividends and thus fall within the scope of application of Art. 7, para. 2.

The *Zythopoiia* judgment may seem to suggest that only those treaty provisions *specifically* devoted to preventing economic double taxation can coexist with the prohibition of Art. 5. However, the judgment, since it refers to a treaty that does not provide for any remedy to the economic double taxation of dividends, cannot tackle more directly the main issue related to Art. 7, para. 2, that is, the applicability of the withholding on dividends in connection with repayment of the tax credit.[32] In the acts of the proceedings, however, considerations emerge which go beyond the case being examined and which prefigure a fairly restrictive interpretation of the provision, such as to exclude in any case the applicability of the withholding at source.[33]

8. The supremacy of EC legislation over tax treaties

The Court has then finally examined another relevant profile, i.e. the relationship between a directive and bilateral treaties against double taxation. The judgment expressly states that (where the exemption in Art. 7 is not applicable) 'the rights conferred on economic operators by Article 5(1) of the Directive are unconditional and a Member State cannot make their observance subject to an agreement concluded with another Member State'.

A similar position was already taken, in the past (*Avoir fiscal* case)[34] with respect to the relationship between a tax convention and the Treaty of Rome. In the *Imperial Chemical Industries c. Colmer* judgment of 16 July 1998 and in *Saint-Gobain ZN*, of 21 September 1999,[35] it was affirmed that, even if the Member States are free to allocate, by means of a treaty, their jurisdiction to tax,[36] they are not exonerated, in doing this, from respect for Community legislation. Similar conclusions have also been drawn from the obligation of cooperation (Art. 5, now Art. 10, of the Treaty).[37]

In summary, the theory is generally accepted according to which, in the Community system, the treaties between Member States are conditioned by institutive treaties.[38] The issue is less settled when it comes to the relationship between bilateral treaties and Community legislation, and the *Zythopoiia* decision becomes the first in which supremacy has been also acknowledged to directives.

In the past, some scholars had reached similar conclusions by remarking the assimilation of tax treaties to the internal law of Member States. Particular importance is attributed to the position, expressed in the jurisprudence of the courts, according to which, on matters regulated by directives, Member States only retain the limited power recognized to them by the directives:[39] this limitation would apply not only to internal law but also to international treaty law.[40] The same authors consider, in another way, that the constant jurisprudence of the courts (in the sense of prevalence of the EC Treaty to agreements concluded between Member States before its entry into force) can also be extended to EC legislation.[41] From an Italian perspective, it has also been considered that, since directly applicable Community legislation prevails on

31 Two points should be made with respect to the Court argument. First, the (limited) taxation of dividends in the source State does not belong to the concept of *economic* double taxation dealt with by Art. 7, para. 2, but rather to the notion of *legal* double taxation. Moreover, it may be said that the Treaty provision related to dividends does not *provide* for double taxation, but merely, consents (within the limit of the Treaty rate) the double taxation arising from the interaction of the jurisdictions concerned.

32 Both the Italian (Circular letter 18 August 1994, no. 151/E) and the French (Instructions 11 March 1994, 14B-1-94) tax authorities have taken the position according to which the Treaty regime (reduced withholding tax and repayment of the tax credit) and the Directive regime (withholding exemption) are alternative. In other words, the repayment of the tax credit implies that the dividend be subject to withholding tax within the treaty rates, notwithstanding the Directive exemption provision. Some scholars have taken a different view. See, G. Maisto, n. 3 above, pp. 93 and 267. This latter opinion has also been supported in two recent decisions by Italian Tax Courts: Comm. Trib. Prov. of Cuneo, 9 March 2000, no. 17 and Comm. Trib. Reg. of Torino, 7 June 2000, no. 20/31/00. See also the related comments by G.L. Queiroli, 'Rimborso della maggiorazione di conguaglio tra normativa comunitaria e normativa convenzionale', *Diritto e pratica tributaria internazionale* 2001, p. 467.

33 Advocate-General, in his Opinion, had taken the position that 'not every provision of a double taxation agreement between Member States of the Community remains unaffected, but only those provisions actually intended to avoid double taxation. By contrast, provisions which merely form part of the balancing of the interests of the States concerned with regard to allocation of the relevant tax revenue, but do not directly prevent double taxation, do not fall within the scope of Article 7(2) of the Directive'.

34 *Commission v France (Avoir fiscal)*, 28 January 1986, 270/83, 1986, ECR, 285, where the Court has stated that 'the rights conferred by Article 52 of the Treaty are unconditional and a Member State cannot make respect make respect for them subject to the contents of an agreement concluded with another Member State'.

35 Cases 264/96, 1988, ECR, I, 4695 and 307/97, 1999, ECR, I, 6161.

36 In the *Gilly* case (12 May 1998, C-336/96) it has however been stated that the different criteria adopted in the treaties among Member States cannot be regarded as constituting discrimination since they derive 'in the absence of any unifying or harmonizing measures adopted in the Community context ... from the contracting parties' competence to define the criteria for allocating their powers of taxation as between themselves'.

37 In *Matteucci*, case 235/87, 1988, ECR, 5589 the Court has stated that, if the application 'of a provision of Community law is liable to be impeded by a measure adopted pursuant to the implementation of a bilateral agreement, even where the agreement falls outside the field of application of the Treaty, every Member State is under a duty to facilitate the application of the provision ...'.

38 See the recent and wide-reaching analysis of P. Pistone, *The Impact of Community Law on Tax Treaties. Issues and Solutions* (Deventer, 2002).

39 Judgment of 7 July 1981, *Rewe c. Hauptzollamt Kiel*, 1981, ECR, 1805.

40 J. Malherbe and D. Berlin, 'Conventions fiscales bilatérales et droit communautaire', Rev. trim. dr. eur., no. 2, 1995, 1995.

41 See also, in case law, the judgment of 27 February 1962, *Commission v Italy*, 10/61, 1962, ECR, 5, where it can be read that 'in fact, in matters governed by the EEC Treaty, that Treaty takes precedence over agreements concluded between Member States before its entry into force'.

domestic law, is should also prevail on statutes that ratify international treaties.[42]

The judgment being commented validates the mentioned opinion and also confirms that the theory of prevalence of Community law is not hampered by the fact that certain Community provisions, including the Directive at the centre of the controversy (435/90/CEE) or the European agreement relative to the legal status of the migrant worker, stipulated in Strasbourg on 24 November 1977 (Art. 23), contain the provision according to which their application does not prejudice the application of bilateral double taxation agreements.

9. Final remarks

The judgment being commented, as for the previous one of 8 June 2000 in the *Epson Europe* case, has the effect of filling a gap in the Directive 90/435/CEE, which consists in its lack of provision of a definition of the concept of 'withholding tax'. Both decisions have involved, even if to a different extent, a consistent extension of this concept, which now exceeds that generally accepted in the individual national systems.

The Court, on the basis of an autonomous interpretation of Art. 5, para. 1, of the Directive and similarly to what happened on the subject of harmonization of VAT and capital duty, has identified a set of criteria for defining the concept of 'withholding tax', which would thus include any national tax which is paid by the company which distributes the dividends; is generated by the distribution of dividends and is in a direct relationship with the amount of the distribution. The most significant development of the judgment being commented is represented by the fact that, by making the concept of 'economic' compensation, the Court has managed to qualify a tax as a withholding tax (at the same time, judged distinct from corporate income tax), the requirement of which occurs exclusively on the head of the distributing body.

It may be discussed whether such conclusion goes beyond the text and the spirit of the Directive. But in a more general perspective, the decision underlines the autonomous nature of Community law and the clash effects that it has on traditional concepts which are well defined in national jurisdictions.

In the light of a possible, future revision of the Directive, the Court ruling sets the issue of the need (or the advisability) of a more precise definition of 'withholding tax' for the purposes of Art. 5, para. 1 (other that the complete listing which was already considered, and later abandoned, in the 1969 Proposal). As an alternative, the adoption of criteria could be evaluated on a similar basis to those developed by the ECJ.[43]

The issue also concerns the proposed directive presented by the Commission in 1998 and concerning the taxation of interest and *royalties* payments between associated companies.[44] It contains numerous autonomous definitions, including for example that of categories of income falling within the objective scope of application. With regard to exemption in the source state, there is a similar formula, even if more wide-ranging than that contained in Art. 5, para.1, of the Directive 90/435/CEE: the exemption concerns, according to Art. 1, para. 1, of the Proposal 'any taxes levied on such income in that Member State, whether collected by deduction at source or by assessment'.

More in general, the issue should be borne in mind in the light of the forthcoming (both targeted and comprehensive) measures envisaged in the recent Commission Communication (COM 582) dated 23 October 2001. The case commented conclusively highlights the difficulties that may arise when, in the EC law-making process, national concepts or principles are implicitly adopted. The interpretative approach, *vis à vis* a EC Act is, in summary, almost opposite to that provided for with respect to international tax treaties. Those latter (at least, when Art. 3 of the OECD Model is followed) are based on the principle that 'any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State', while it is now clear (also with respect to the possible effects) that, in EU legislation, national law comes into play only when expressly referred to.

Such circumstance – now consolidated and repeated in the judgment being commented – presents the only choice of providing comprehensive definitions, making expressed reference to national concepts or to entrusting definitions entirely to the jurisdiction of the Court, sometimes with results – as in the case being examined – which can be difficult to forecast.

42 R. Pisano, 'Il rapporto fra norme interne, diritto convenzionale e diritto comunitario', in V. Uckmar and C. Garbarino (eds.), *Aspetti fiscali delle operazioni internazionali* (Milan, 1995), p. 432.

43 The mentioned Commission Communication of 23 October 2001 opens the way to a more penetrating role of the Court case law on the community tax policy. The Commission envisages the opportunity to 'develop a more general understanding of the impact of important rulings by the European Court of Justice (ECJ) on Member States' company tax rules and double taxation treaties' and 'to develop guidance on important ECJ rulings and to co-ordinate, via appropriate Communications from the Commission, the implementation of these'.

44 European Commission, Proposal for a Council Directive on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, Brussels, 4 March 1998, COM (1998)67def., in OJ, C 22 April 1998, p. 9.